The Federal Report

California Public Employees' Retirement System

The Month in Washington: May, 2008

The presidential primary season wound down, with both the leading candidates and Congress shifting gears with an eye toward November. Congress overrode a presidential veto on the farm bill as Members scrambled to build their credentials for their own elections, and another override of a veterans benefit bill seems likely. There is little time remaining before the extended break for legislators this summer, and then only a brief time for work before campaigning for the general elections starts in earnest. The Supreme Court was active on benefit issues and regulators continued to explore ways to prevent current problems in credit and underwriting from occurring again.

Issues and Events

Genetic Nondiscrimination Act Becomes Law

President Bush signed the Genetic Information Nondiscrimination Act (GINA) on May 21. Senate champion Olympia Snowe (R-ME) called the legislation the first time in American history that the law has banned discrimination before it set in while others have termed GINA the first civil rights law of the 21st Century. Genetic testing involves diagnosing likely future conditions, and the law does not substantially affect current law on using information about conditions from which an individual currently suffers.

The Act bans discrimination based upon genetic information in both employment and insurance. It responds to concerns that the public was avoiding genetic testing, an increasingly powerful tool for early prevention of chronic medical conditions, because of fears that the information would be used against them at work or in medical coverage. To assuage these concerns, the law makes use of genetic test information illegal as the basis for a hiring, firing, or other employment decision and prevents insurers from using such information for coverage or premium determinations. Employers and insurers are barred from requiring genetic testing as a condition of employment or coverage. In the case of violations by health plans, participants can sue for injunctive relief under ERISA, with administrators potentially found personally responsible. The measure requires confidentiality of genetic information similar to that provided under the Health insurance Portability and Accountability Act of 1996 (HIPPA) for medical records. GINA also pre-empts any State law deemed to be more stringent than the Federal statute.

The health plan provisions become effective in May of 2009, with the employment provisions following in November of that year. It remains to be seen if the Act will ease the concerns of the public about genetic information and spur more testing among the population, which experts believe will improve treatment and lower costs.

Veterans Benefit Bill Clears House and Senate by Huge Margins

Legislation to reward military service, the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 (H.R. 6081) passed the House of Representatives on a 403-0 vote on May 21. The legislation provides tax incentives, including several of interest to pension plans.

The bill makes the provision allowing active duty reservists to make penalty free withdrawals from retirement plans permanent. In addition, the bill modifies the Uniformed Services Employment and Re-employment Rights Act (USERRA) to allow the day prior to death to be treated as the date of re-employment for activating benefits under a qualified plan and to allow service members to have six months to draw down funds from a Flexible Spending Arrangement. Employers could make contributions on behalf of a employee who has died or been disabled in combat duty and roll a death benefit into a Roth IRA or Education Savings Account. The Senate approved the bill by unanimous consent on May 22. There has been no reported White House opposition to this measure, which seems well-placed to become law.

This legislation is a separate matter from the more widely publicized effort to broaden and "update" the G.I. Bill of Rights to expand education assistance to the current group of veterans who have served in Iraq (S.22). That legislation passed the House and Senate as part of war funding bills by veto-proof majorities, and it remains to be seen whether the White House will move forward with its promised veto and force a situation where it has been overridden twice in two weeks (the first was on the Farm bill).

Supreme Court Defends Workplace Discrimination Remedies

On May 27, the Supreme Court ruled that victims of discrimination can sue in Federal Court, and that anti-discrimination laws based on race and age also apply to the Federal government. The Court also found that same laws that protect workers from discrimination also protect them from retaliation, even if that protection is not explicit in statute.

The new causes of action come from two cases. The first, decided on a 7-2 ruling, allowed a civil rights law from 1866 to be applied to a contemporary case alleging retaliation for pursuing a discrimination claim (*CBOCS West v. Humphries*). While dissenter Clarence Thomas wrote that retaliation provisions do not occur in the text of the legislation, Steven Breyer, writing for the majority, found that anti-retaliation is "embedded" in the Act. The second case, *Gomez-Perez v. Potter*, resulted in a 6-3 decision that concluded Federal workers are protected against retaliation under the Age Discrimination in Employment Act (ADEA). The decision written by Samuel Alito said that the ADEA's language against "discrimination based on age" in the portions of that act that concern Federal employees also implicitly "includes retaliation based on the filing of an age discrimination complaint." Here Chief Justice Roberts disagreed, asserting that Congress intends to protect Federal employees through the Civil Service system and that Congress "did not intend those employees to have a separate judicial remedy for retaliation."

Reaction to the rulings fell along predictable lines, with business groups expressing disappointment and civil rights groups approving, if surprised by this turn by a fairly pro-business Court.

Commodity Curbs Considered

The Chairman of the Senate Homeland Security and Government Affairs Committee, Joe Lieberman (I-CT) said that recent disruptions in the oil, food, and other commodity markets might merit legislation to restrict "speculation" by institutional investors that roil the markets and bid up prices.

"We may need to limit the opportunity people have to maximize their profits because a lot of the rest of us are paying through the nose, including some who can't afford it," Lieberman said at a May 20 hearing, where the Chairman specifically noted the increased involvement of pension funds in the commodities markets. Lieberman wondered if food and energy prices were "being driven by irrational speculative behavior, a rational response to market fundamentals, or a combination of both?" The top Republican of the panel, Senator Sue Collins (R-ME), seemed to concur by noting in her statement that, "I believe the Commodities Futures Trading Commission [CFTC] must also look into legal practices such as large commodity-linked financial products by institutional investors to ensure that they are not disrupting essential market functions or exerting artificial pressure on the price of underlying commodities."

Senate Panel Strikes Housing Deal

After weeks of wrangling, Senate Banking Committee Chairman Chris Dodd (D-CT) and Ranking Republican Richard Shelby (R-AL) forged a compromise passed by their committee on a 19-2 vote, with 8 Republicans joining all Democrats to approve the measure. The vote occurred May 20.

The housing relief bill, intended to aid troubled borrowers by allowing them to refinance under certain conditions, turned the corner against a threatened veto by tapping two Government-Sponsored Enterprises (GSE's) for funding in order to absolve taxpayers of direct liability. Fannie Mae and Freddie Mac, in addition to getting a more powerful and unified regulator sought by the Administration, would also capitalize the new relief fund to the tune of $500 million, which would be used to provide incentives to lenders and help to borrowers. The core of the plan remains a mechanism for lenders to write down principal on troubled loans and refinance lending for borrowers to create mortgages that they can realistically pay.

Fannie Mae and Freddie Mac, like other GSE's, are technically private but seen as implicitly backed by the government, and hence the taxpayers. However, the compromise removes the direct route from troubled home loans to the U.S. Treasury, and that could be enough to address the concerns of the White House, which had threatened to veto a House measure passed earlier this month that lacked this kind of insulation for the taxpayers.

The measure could come before the full Senate when the body returns from a district work period on June 1.

California Congressional Delegation

The advances in benefits to reward and honor the nation's soldiers such as the HEART Act and the expanded G.I. Bill could not have been achieved without the commitment of Congressman Bob Filner (D) of California's 51st District, which includes south San Diego and the entire border with Mexico in the State. Filner chairs the House Committee on Veterans' Affairs and has overseen a constant flow of hearings to monitor the mental and physical health of returning veterans and investigate their needs.

Related National and Industry News

Suits to Test Limits of LaRue on 401(k) Litigation

Fresh from the U.S. Supreme Court decision to allow participants to sue a plan for individual harm (*LaRue v. DeWolff*, 06-856), a new question for 401(k) sponsors and managers is whether former participants may also make such claims.

A lawsuit alleges that Principal Financial Group duped participants into rolling over their accounts from the company 401(k) to Principal's mutual funds when the employees were separated from service. While many would see this as an issue in need of relief if true, it remains an open question how the controversy involves ERISA.

"To find that Plaintiffs have standing under § 1132(a)(2) [of ERISA] on this factual scenario would require the Court to expand ERISA protection to include 'former' plan assets," the judge wrote in *Young v. Principal Financial Group Inc.*, S.D. Iowa, No. 4:07-cv-00386, 4/21/08. "The Court does not believe that ERISA or LaRue supports such an extension. The Court recognizes the potential unfairness that may result from its refusal to extend LaRue. Assuming Plaintiffs' allegations are true, denying them standing under § 1132(a)(2) will essentially reward Defendants for their misdeeds. To grant standing, however, would unduly and inappropriately expand ERISA, potentially opening the door to lawsuits against anyone who offered investment advice for, or exercised authority over, assets that had once been part of an ERISA plan. This is not the intent of the law, and the Court cannot rewrite the statute to provide a remedy where none exists."

The issue will be resolved as it works its way further through the court system.

SEC Enforcement Budget Partially Blamed for Bear Stearns Collapse

The slight but steady decline of enforcement funds and personnel at the Securities and Exchange Commission (SEC) could have played a part in the abrupt demise of Bear Stearns. So claims former SEC Commissioner Harvey Goldschmidt, who left the agency in 2005 and now teaches at Columbia Law School, and members of the Senate Banking Committee at least entertained the idea at a hearing on May 7. From 2005 to 2007, the SEC lost 1.3% of its budget and 386 (10% of its total) full-time employees while the regulated community expanded their revenues, staff, and share of revenues based on structured credit instruments. It is probable that the problems with Bear Stearns, even if seen as an SEC failure, will result in a budget increase for the regulator in the next appropriations cycle.

Retirement Apprehension Grows With Sour Economy

Confidence in a comfortable retirement dropped 7% from last year, according to a new Gallup poll, with only 46% of those surveyed believing they will attain a good standard of living after their working years. Of the choices offered, 63% selected "Not having enough money for retirement" as their top financial concern while 56% picked medical costs as their chief worry. Americans are starting to feel that they will have to rely more on their personal retirement (up 2%, to 54%) but also expressed a higher belief that Social Security would be their main source of retirement funds (31% versus 27% one year ago). Hope that an employer-provided plan would help in retirement dropped 5 points to 26% and confidence in using home equity for retirement fell 4 points to 26%.

Moody's Woes Continue; International Guidelines Pending

The International Organization of Securities Commissions (IOSCO) announced plans for a variety of changes for the ratings industry. In an initiative sure to sting the ratings giants, IOSCO proposes that these companies will no longer be allowed to rate securities they design and that new ratings are needed to distinguish between structured bond products and corporate securities. Ratings companies may also face registration and reporting requirements but IOSCO did not follow through on hard-liner's plans to dictate fee structures and other more invasive rules for the industry.

The new directives "will be sturdy rules based on the lessons learned in the subprime experience," said Chris Cox, Chairman of the U.S.' Securities and Exchange Commission (SEC). "We're going to prohibit the kinds of practices that were found to be particularly troublesome in the subprime crisis, so conflicts of interest will either be flat-out prohibited or subjected to procedures to minimize those conflicts," Cox said. The SEC has sent letters to the main raters (Moody's, Standard & Poor's and Fitch) inquiring about the firms' methodology, procedures, and error detection practices.

Like many international groups, IOSCO has no direct regulatory power but instead works through its members to promulgate consistent regulations for global finance. That restriction means that any attempt to rein-in the raters will return to the SEC and possibly Congress for the final details to be worked out.

Investors also learned that credit ratings giant Moody's granted its coveted AAA rating to undeserving securities due to a faulty computer model used to analyze securities. According to the *Financial Times*, which broke the story, some Moody's personnel knew about the bug in early 2007 and that the actual rating should have been up to four spots lower. The securities held their erroneous rating until January 2008, when they were down-graded with other securities tanking in the general market turmoil of the period.

Moody's told the *Financial Times* that it "regularly changes its analytical models and enhances its methodologies for a variety of reasons, including to reflect changing credit conditions and outlooks. In addition, Moody's has adjusted its analytical models on the infrequent occasions that errors have been detected. However, it would be inconsistent with Moody's analytical standards and company policies to change methodologies in an effort to mask errors. The integrity of our ratings and rating methodologies is extremely important to us, and we take seriously the questions raised about European CPDOs. We are therefore conducting a thorough review of this matter."

The disclosure will almost certainly not help the rating agencies on Capitol Hill, where many angry legislators see them as having a pivotal role in the credit market meltdown.